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Financial Markets

Irving Trust

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Rates moved sharply higher this week. The most important economic news was the unexpectedly strong 2.5% increase in the June index of leading indicators reported Wednesday. On the same day, the Treasury confirmed expectations of a huge supply of new debt to be issued this quarter. Against a background of heavy supply currently weighing on the corporate and municipal bond markets, the near-term outlook for bond prices looked distinctly bleak.

But the real source of concern was the run-up of the Federal funds rate, which averaged well over 9% during the week. The market interpreted the rising pattern as a signal that the Federal Reserve had tightened its policy stance--or at least that it had not eased the previous week, as many had believed.

In our view, the Fed was encountering significant problems in projecting reserve supplies, and likely did not make a policy change. To start with, the Fed sold bills on Thursday, as expected, in order to offset the impact of the previously announced reductions of reserve requirements. Probably some time Friday the Fed began to receive major revisions to its reserve projections, for that evening it made the rather extraordinary announcement that due to "significant operating problems" the scheduled release of the special deposits of money market mutual funds was to be advanced by two weeks to Monday. This operation added reserves. On Monday, as funds began to firm slightly from the 8 3/4% opening rate, the Fed again added a modest amount of reserves through customer RPs. Nevertheless, the rate gradually traded up during the day and opened on Tuesday at 9 1/8%. After the rate had again advanced somewhat, the Fed added reserves through its own RPs. Nevertheless, funds continued to firm. On Wednesday, the Fed did no open market operations despite a gradual firming of the rate during most of the day. However, the Bundesbank was intervening to support the DM that day by selling dollars, which it probably obtained by selling bills to the Fed. This operation would have added reserves and would have been viewed by the Fed as a restraint on the rate rise. Again on Thursday, substantial Bundesbank intervention probably produced a reserve add, though it was not visible on the market. In the face of upward rate pressures, the Fed also added reserves through executing its own RPs on both Thursday and Friday.

Though it is impossible to be certain at this stage, the pattern of operations points to efforts by the Fed to offset an emerging unanticipated reserve shortage. Indeed, amid all the sound and fury, the weekly average effective funds rate came in at 8.98% for the statement week ended Wednesday, up only slightly from the week before. Hence the record does not indicate that the Fed has moved to a tighter posture, despite the recent firmness.

Looking further ahead, we continue to anticipate lower short-term rates, but the pace of the declines should be gradual. Last Friday's large $2.5 billion increase in M1B lifted that aggregate to the bottom of its 4%-6 1/2% target range. For the time being, the Fed is almost certain to be satisfied with that.

William C. Melton

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Market Yields

	8/1/80	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	(noon)		
Short-term loans to substantial depositors with highest credit rating	11.00%	11.00%	11.75%
Effective since	7/24/80		
Discount Rate at Federal Reserve Bank	10.00	11.00	10.00
Federal Funds	10.63	8.63	10.63
Repurchase Agreements	9.50	8.50	9.60
U.S. Treasury Issues			
Bills			
3 months	8.88	8.25	9.70
6 months	9.17	8.44	9.95
1 year	9.28	8.60	9.68
Coupons			
2 years	9.61	9.03	9.25
4 years	9.90	9.42	8.96
7 years	10.00	10.15	8.90
10 years	10.65	10.20	8.92
Long Bond	10.62	10.24	8.92
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.90	8.50	10.10
3 months	9.90	8.55	10.30
6 months	10.00	8.70	10.45
1 year	10.25	9.00	10.40
Banker's Acceptances			
1 month	9.55	8.50	10.18
3 months	9.55	8.50	10.35
6 months	9.55	8.45	10.50
Eurodollar Deposits			
1 month	10.38	8.88	10.94
2 months	10.44	8.94	11.00
3 months	10.50	9.06	11.00
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.00	7.00	9.63
1 month	8.75	8.38	9.95
3 months	8.75	8.38	9.75
Bank Holding Companies			
1 month	8.63	8.38	10.00
Dealer Placed:			
3 months	8.50	8.38	10.10
New AA Corporate Utility Bond	12.50	11.90	9.70
Tax Exempt			
6 month Project Notes	4.40	4.55	4.95
1 year AAA Bond	5.10	5.10	N/A
5 year AAA Bond	5.50	5.40	N/A
20 year AAA Bond	7.85	7.20	5.75

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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